CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: THE UNLIMITED STORE, INC,, dba The Unlimited Store Petitioner	Account Number SR Y KH 101-028436 Case ID 522301 Rancho Cordova, Sacramento County

Type of Business: Cell phone retailer

Audit period: 02/01/08 – 09/30/09

Item	Disputed Amount
Unreported taxable sales	$220,417
Negligence penalty	$ 26,446

	Tax	Penalty
As determined	$380,359.93	$38,036.00
Pre-D&R adjustment	-115,900.93	-11,590.11
Proposed redetermination	$264,459.00	$26,445.89
Less concurred	-245,868.51	00.00
Balance, protested	$ 18,590.49	$26,445.89

Proposed tax redetermination	$264,459.00
Interest through 03/31/13	78,572.05
Negligence penalty	26,445.89
Total tax, interest, and penalty	$369,476.94
Monthly interest beginning 04/01/13	$ 1,322.30

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments are warranted to the understatement of reported taxable sales. We find no additional adjustments are warranted.

Petitioner sold Metro PCS cell phones and accessories at 23 locations throughout Northern California during the period February 2008 through October 2011. The Sales and Use Tax Department (Department) mailed petitioner an audit engagement letter requesting that petitioner contact the Department to schedule an audit appointment. After petitioner failed to contact the Department, the Department obtained petitioner's merchandise purchase information from Brightpoint, Inc., petitioner's only known cell phone supplier and, using an estimated markup of 48 percent, computed audited taxable sales of $4,686,161 for which the Department issued a Notice of Determination (NOD). After receiving the NOD, petitioner contacted the Department and presented cell phone purchase information for the liability period, quarterly sales summaries for each location, and sales invoices for July 2008 and July 2009. However, the Department found various discrepancies in the records that it considered strong evidence that reported sales were substantially understated. Therefore, the Department decided to recompute audited taxable sales based on a markup analysis.

Based on the merchandise purchase information obtained from petitioner's supplier, the Department established audited merchandise purchases of $3,602,280, which exceeded merchandise purchases provided by petitioner by $162,235. By comparing costs from purchase invoices with sale prices, including sales tax reimbursement, from sales invoices for July 2008 and July 2009, the Department computed cell phone markups of 39.01 percent for 2008 and 30.27 percent for 2009. The Department added the markups of 39.01 percent and 30.27 percent to the audited cell phone purchases for the respective partial years, and then made adjustments to exclude sales tax reimbursement, which resulted in audited taxable sales of cell phones of $4,524,190 for the liability period. Since information regarding petitioner's purchases of accessories was unavailable, the Department computed taxable sales of accessories as a percentage of petitioner's cell phone sales. Using 26 sales invoices, the Department calculated a ratio for sales of accessories of 6.408 percent, which it applied to audited taxable sales of cell phones to establish audited taxable sales of accessories of $272,568. Initially, the Department computed audited taxable sales of cell phones and accessories combined of $4,796,758 for the liability period. However, a post-conference adjustment to allow 1 percent for pilferage in the markup analysis resulted in a reduction of $43,166 to audited taxable sales. Following the allowance for pilferage and excluding a separate deficiency measure of $456,600 for the difference between recorded and reported taxable sales, the Department established a deficiency measure of $2,863,894 for unreported taxable sales.[1] The total deficiency measure of $3,320,494 ($2,863,894 + $456,600) represents a reduction of $1,365,667 from the amount originally established for the NOD.

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[1] In the D&R, we recommend that the deficiency measure for unreported taxable sales be reduced to $2,851,541. However, following the issuance of the D&R, the Department corrected an error in its computations, which resulted in unreported taxable sales of $2,863,894.

Regarding the difference of $162,235 between the cell phone purchases shown in the information obtained from Brightpoint, Inc., and petitioner's recorded purchases, petitioner contends that the difference results from purchases shown in the information from Brightpoint, Inc. under a different customer number (283423). Petitioner claims that these purchases were delivered to another Metro PCS store located within the same strip mall as petitioner's location. However, the Department found that petitioner took over the lease of its suite at the strip mall from an existing Metro PCS store on January 1, 2008, the former lessee (Brightpoint customer number 283423) closed its seller's permit effective December 31 2007, and petitioner added this location to its seller's permit effective January 31, 2008. Brightpoint, Inc. continued to deliver cell phones to that address in 2008. Since petitioner has provided no documentation to indicate that it rejected or returned the merchandise deliveries recorded under its predecessor's customer number, we conclude that petitioner purchased the merchandise at issue, such purchases were properly used in the computation of audited taxable sales, and no other adjustments are warranted.

Issue 2: Whether petitioner was negligent. We conclude that it was.

The Department imposed the penalty because petitioner consistently understated its sales by a large margin throughout the liability period. Petitioner states that it thought tax was due on its cost of cell phones, and contends that the understatement was due to its inexperience rather than negligence. However, given that petitioner's recorded merchandise purchases of $3,440,045 substantially exceed its reported taxable sales of $1,447,039 for the liability period, we conclude that the understatement did not result from petitioner reporting costs of sales based on a misunderstanding of the law. A comparison of reported taxable sales of $1,447,039 with the total deficiency measure of $3,308,341, including $456,600 for the difference between recorded and reported taxable sales, shows an error rate of 229 percent, which is substantial evidence of negligence in reporting. Thus, even though this was petitioner's first audit, we conclude that petitioner was negligent and the penalty was properly applied.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentage developed	39.01% (2008) 30.27% (2009)
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	$36,023
Pilferage allowed as a percent of taxable purchases	1%